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SUBJECT: ROMANIA: NEW COALITION'S ECONOMIC PLAN A MOVING TARGET

REF: BUCHAREST 961 AND PREVIOUS

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#### SUMMARY

1. (SBU) The new PDL-PSD coalition government announced a ruling program full of campaign promises and political sweeteners prior to officially taking power on December 22, but has just as quickly begun to back away from many of those positions in its first two weeks in office. New Prime Minister Emil Boc's first official statements have emphasized fiscal policy "prudence" and "coherence" in the face of the economic downturn, and his government has taken some early steps to cut expenditures. Still, the coalition's revenue and spending plans don't add up, and uncertainty as to how the Government of Romania (GOR) will actually manage the deteriorating economic situation will likely keep financial markets depressed into the New Year. The overall program maintains rather rosy assumptions about future growth and new spending but makes no mention of the 50 percent hike in teacher's wages, anticipation of which helped precipitate a breakdown in Romania's sovereign debt rating and fiscal outlook in the fall. Ultimately, the ruling program should be seen as more of a political statement rather than a concrete governing plan, and will be subject to extensive revision by the Parliament as it drafts the 2009 budget in early January.  
End summary.

#### AN AMBITIOUS, COSTLY, AND OPTIMISTIC GOVERNING PROGRAM...

2. (SBU) If fully implemented, the PDL-PSD ruling program as announced the week of December 15 would worsen Romania's progressively bleak fiscal situation. Apparently eager to demonstrate responsiveness to voters who supported them on November 30, the PSD and PDL cherry picked the most popular parts of their respective economic platforms and linked them together into one shared statement. For its part, the PSD compromised on income taxes, agreeing to the preservation of the 16 percent flat tax on income and capital gains provided that the value added tax (VAT) on basic foodstuffs (a major source of GOR revenue) would be cut from 19 to 5 percent. As a further sop to PSD voters, the coalition document proposed additional, as yet unspecified, individual tax exemptions for low income individuals. In order to preserve a semblance of fiscal discipline, the parties proposed to partially offset the VAT cut on food by raising the VAT on luxury goods to 25 percent and slapping a new 19 percent tariff on real estate transactions for commercial purposes.

3. (SBU) No sooner had the government taken office, however, than it signaled it was likely to keep current VAT levels unchanged, creating widespread confusion over which position will actually prevail when Parliament writes the budget. Other targets for additional revenue in the program are a new corporate windfall profits tax (which would affect energy producers like OMV-owned Petrom), and better revenue collection through improved enforcement,

something every new government has promised and which fiscal analysts say is very much needed, but which the GOR's track record to date suggests is unlikely to produce dramatic results. Finally, local taxes on buildings, cars, and motorboats will all increase, with an eye toward reducing the amount of money the central government transfers annually to local municipalities.

¶4. (SBU) On the spending side, the GOR program makes the obligatory nod toward increasing retirement pensions as a long-term goal and proposes a vigorous highway construction program. The new government promises more social programs targeting youth and young adults, including more state assistance for young, first-time home buyers. Firms will be eligible for incentives if they hire young people. Reflecting the priority on young and future voters, the National Agency for Youth has been upgraded to a full Ministry with a larger budget, charged with implementing a vague program of "active social security systems for the youth." Farmers receive something as well, with the promise of government funds to assist in the marketing of agricultural products and a cut in the diesel fuel excise tax for farmers (subject to EU commission approval) from 80.90 euros to 21 euros per metric ton. For workers, the ruling program presages a steady increase in the monthly minimum wage, with the goal of pushing it to 500 euros (or at least 50 percent of the gross average wage) over the next five years.

¶5. (SBU) The governing plan assumes a best-case macroeconomic scenario in 2009, projecting GDP growth of 3.5 percent, inflation decreasing to 5 percent, and a cut in the current account deficit to 11.1 percent of GDP. Less likely to be achieved, given the hefty spending already promised by the outgoing Parliament, is a programmed budget deficit of only 2.5 percent of GDP. (This is in contrast to the new forecast by international ratings agency Fitch,

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more representative of private sector views, predicting just 1 percent GDP growth and the budget deficit reaching 5 percent of GDP in 2009.) Much will hinge on any actual modifications to the tax code. To revive the broader economy, the new government promises to increase credit availability to small and medium enterprises and to cut capital market trading costs in an effort to stem the outflow of foreign portfolio investment on the Bucharest Stock Exchange.

...TOSSED OVERBOARD IN THE FIRST TWO WEEKS

¶6. (SBU) In light of the rapidly deteriorating economic situation, however, the campaign platforms touted in advance of November's parliamentary elections are ancient history. Since taking office December 22, PM Boc and some Cabinet members, with support from President Traian Basescu, have indicated they are already jettisoning some of the campaign's most notable promises. Despite agreement among the parties to allocate six percent of GDP to education, the PDL-PSD program conspicuously makes no mention of the 50 percent increase in teacher salaries which became law in November; former PM Tariceanu had been strongly criticized by Boc, Basescu, and PSD leaders when he refused to implement it. Teachers' unions are already threatening new strikes after the New Year if the raise is denied. Also gone by the wayside is a promised January 1 hike in pensions for certain categories of retirees. New Minister of Labor Marian Sarbu has announced he wants major changes to a generous maternity leave and benefits law, passed in November, under which the state would pay an income supplement for up to two years for women who leave their jobs to give birth. Sarbu, who has characterized the law as "poorly conceived," is now under fire from PNL opponents who note he was vice-president of the parliamentary committee which first approved the legislation without opposition two months ago.

¶7. (SBU) The Boc Government is also targeting public sector salaries. Through the end of 2009, directors of state-owned enterprises will see their monthly salaries cut to the level of state secretaries, or 4,100 lei (around USD \$1450), a huge reduction considering that current directors of Romgaz and Hidroelectrica, for instance, make around 27,000 lei (USD \$9,600) per month. The GOR will freeze hiring for the approximately 140,000 positions government-wide which are currently vacant, with the exception of law enforcement/judicial jobs or (tellingly) positions responsible

for accessing and processing EU funds for various programs. For his part, new (and former) Transport Minister Radu Berceanu called a press conference to announce he is immediately dismissing all 24 of the agency directors under him (including leaders of the National Highway Authority, air traffic control agency Romatsa, Bucharest's two airports, and national airline Tarom). Berceanu justified the move on the basis of the "excessive" salaries of these officials, but outgoing minister Ludovic Orban claimed this was merely a pretext for politicization of the ministry with new appointments, noting that the officials' salaries had not changed significantly since Berceanu was minister the last time.

#### COMMENT

18. (SBU) The accelerating economic downturn -- GOR tax revenues are off more than 30 percent in the last quarter of 2008 -- is forcing major adjustments in the new Government's plans. While some analysts applaud the new atmosphere of austerity as just what the doctor ordered, others believe that major spending cuts due to Romania's deficit financing troubles will push the economy even faster towards a recession, since government spending now represents more than 35 percent of GDP. The Boc Government's willingness so quickly to abandon campaign commitments is also a two-edged political sword: foreign investors, financiers, and ratings agencies may look favorably on this new dose of fiscal reality, but large numbers of voters certainly will not. Most likely to be disappointed are PSD supporters; their party now controls major social ministries like labor, education, and health, but with the PD-L holding the purse strings at the ministries of economy and finance, the PSD will be hard pressed to secure funding for its priorities. The stage is already set for a tug of war within the coalition when the new Parliament begins crafting the 2009 budget in early January. End Comment.

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